SENATE FISCAL AGENCY

NOTES ON THE BUDGET AND ECONOMY

November/December 2001

BALANCING THE FY 2001-02 GENERAL FUND/GENERAL PURPOSE AND SCHOOL AND FUND BUDGETS

by Gary S. Olson, Director

On February 8, 2001, Governor John Engler presented to the Legislature his recommendations for fiscal year (FY) 2001-02 General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) appropriations. This budget presentation by the Governor marked the beginning of a State fiscal year characterized by a slumping national and Michigan economy which resulted in significant downward revisions in the estimated amount of GF/GP and SAF revenues available to support appropriations. These downward revisions in the revenue estimates led to major adjustments to the overall FY 2001-02 State budget originally recommended by the Governor. This article provides a summary of the adjustments that were made to the Governor's original FY 2001-02 GF/GP and SAF budgets in order to keep the budgets in balance.

FY 2001-02 GF/GP Budget Balancing

The Governor's original FY 2001-02 GF/GP appropriation recommendations provided for $9.78 billion of spending. This level of appropriations was consistent with the consensus revenue estimate agreed to on January 11, 2001. Legislative action on the FY 2001-02 appropriation recommendations of the Governor continued until May 15, 2001, when the consensus revenue estimate for FY 2001-02 GF/GP revenues was revised downward to a level of $9.27 billion. This $514.5 million downward revision in the FY 2001-02 GF/GP consensus revenue estimate forced the Legislature to make significant adjustments to the Governor's original appropriation recommendations. During July 2001 the Legislature completed action on the FY 2001-02 appropriation bills and passed a balanced budget based on the May 15, 2001, consensus revenue estimate.

During the summer and fall of 2001 it became apparent that the May 15, 2001, consensus estimate of FY 2001-02 GF/GP revenues would have to be revised downward as well. On October 23, 2001, the Consensus Revenue Estimating Conference held a special meeting and reduced the FY 2001-02 GF/GP consensus revenue estimate by another $462.4 million to an estimate of $8.8 billion. This further reduction in the consensus revenue estimate forced the Legislature and the Governor to make additional adjustments to the FY 2001-02 State budget in order to keep a balance between estimated revenues and appropriations. These adjustments were completed by the Legislature on November 8, 2001.

The two downward revisions in the FY 2001-02 GF/GP consensus revenue estimate totaled $976.8 million or a 10.0% drop from the original consensus revenue estimate that was the basis for the Governor's original FY 2001-02 budget recommendations to the Legislature. This substantial revision in the consensus revenue estimate forced the Legislature and the Governor to make significant adjustments in the budget. These adjustments to the FY 2001-02 GF/GP budget also will have an impact on the FY 2002-03 GF/GP budget.

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Table 1
FY 2001-02 General Fund/General Purpose Budget Summary
Governor's Recommendation to Final Enacted Budget
(millions of dollars)

Governor's Original Appropriation Recommendations	$9,784.6
October 2001 Consensus Revenue Estimate	8,807.8
Difference	$ (976.8)
Actions Taken to Balance Budget:	
GF/GP Appropriation Reductions	$ 430.7
Budget Stabilization Fund Withdrawal	155.0
Merit Award Trust Fund Transfers	131.5
Tobacco Settlement Trust Fund Transfers	27.5
Transportation Funding Shifts	63.0
Revenue Sharing Reductions	65.1
Other Restricted Revenue Adjustments	3.3
Sale of Surplus State Property	64.6
Tax Amnesty Revenue	15.5
Work Project Reductions	20.7
Total Adjustments to Balance Budget	**$976.9**

Table 1 provides a summary of the adjustments that were made to balance the FY 2001-02 GF/GP budget as a result of the $976.8 million reduction in estimated revenues. These adjustments included a combination of appropriation reductions, transfers to the General Fund from other State restricted funds, the revenue generated from the sale of surplus State property, and revenue from a tax amnesty program. Reductions in the level of GF/GP appropriations originally recommended by the Governor totaled $430.7 million. The next largest budget adjustment was a $155.0 million transfer from the Budget Stabilization Fund to the General Fund. Transfers of surplus tobacco settlement funds in the Tobacco Settlement Fund and the Merit Award Trust Fund totaled $131.5 million and $27.5 million, respectively. Restricted State transportation funds of $63.0 million and other State restricted funds of $3.3 million were transferred to the General Fund. Revenue sharing payments to cities, villages, townships, and counties were reduced by $65.1 million; $15.5 million of new revenue is anticipated to be collected from a tax amnesty program; and $20.7 million of revenue will be generated from the suspension of previously authorized work projects. The final piece of the overall budget solution is $64.6 million of revenue that is expected to be generated from the sale of the Northville Psychiatric Hospital.

FY 2001-02 School Aid Fund Budget Balancing

When the Governor introduced his FY 2001-02 State budget recommendations to the Legislature on February 8, 2001, the School Aid Fund (SAF) budget for FY 2001-02 had already been enacted into law by Public Act 297 of 2000. This appropriation bill provided for FY 2001-02 SAF expenditures of $11.52 billion and was based on the January 11, 2001, consensus revenue estimates. The impact of the slumping national and Michigan economies resulted in significant downward revisions in the FY 2001-02 SAF revenue estimates. These downward revisions in the SAF revenue estimates resulted in projected deficits in the FY 2001-02 SAF year-end balances.

Table 2 provides a summary of the changes that occurred in the FY 2001-02 SAF budget since the January 11, 2001, consensus revenue estimates were completed. A comparison of the original

SAF appropriations contained in Public Act 297 of 2000 and the October 23, 2001, consensus estimate of FY 2001-02 SAF revenues led to a $399.1 million projected deficit. This potential budget deficit was eliminated by three adjustments to the budget. The first was appropriation reductions which totaled $70.0 million and were contained in Public Act 121 of 2001 and Executive Order 2001-9. Two sources of additional revenue were added to the SAF budget, they included a $322.5 million transfer from the Budget Stabilization Fund and an estimated $6.6 million of new revenue that will be credited to the SAF from the tax amnesty program.

In summary, the deteriorating economic condition in the State over the past year has forced the Governor and the Legislature to take many steps to ensure that the FY 2001-02 GF/GP and SAF budgets continue to be in balance between estimated revenues and enacted appropriations. The actions taken to balance these budgets will have an impact on future State budget decisions.

Table 2
FY 2001-02 School Aid Fund Budget Summary
Governor's Recommendation to Final Enacted Budget
(millions of dollars)

Governor's Original Appropriation Recommendations	$11,521.0[a)]
October 2001 Consensus Revenue Estimate	11,121.9
Difference	$ (399.1)
Actions Taken to Balance Budget:	
School Aid Fund Appropriation Reductions	$ 70.0
Budget Stabilization Fund Withdrawal	322.5
Tax Amnesty Revenue	6.6
Total Adjustments to Balance Budget	**$399.1**

a) Public Act 297 of 2000.

A NEW TWIST TO AN OLD PRACTICE: MICHIGAN'S CONSERVATION RESERVE ENHANCEMENT PROGRAM

by Craig Thiel, Fiscal Analyst

Introduction

In September 2000, the State of Michigan signed an agreement to partner with the United States Department of Agriculture (USDA) to implement the Conservation Reserve Enhancement Program (CREP), an offspring of the nation's largest private lands conservation program, the Conservation Reserve Program (CRP). This program was authorized under the 1996 Federal Agriculture Improvement and Reform Act. The Conservation Reserve Enhancement Program is a voluntary program for agricultural landowners designed to protect environmentally sensitive land, increase wildlife habitat, and safeguard ground and surface water resources. Similar to the CRP, CREP relies on financial incentives to encourage agricultural landowners to enroll eligible land in 15- year contracts to keep the land out of agricultural production and implement specific conservation practices. The estimated cost of the program over the next 15 years is $170.5 million, with $145 million coming from Federal sources and $25.5 million coming from

State and private sources. To date, 17 states, including Michigan, have partnered with the USDA to develop a state-specific CREP and many more states are working on their CREP proposals.

Michigan's CREP

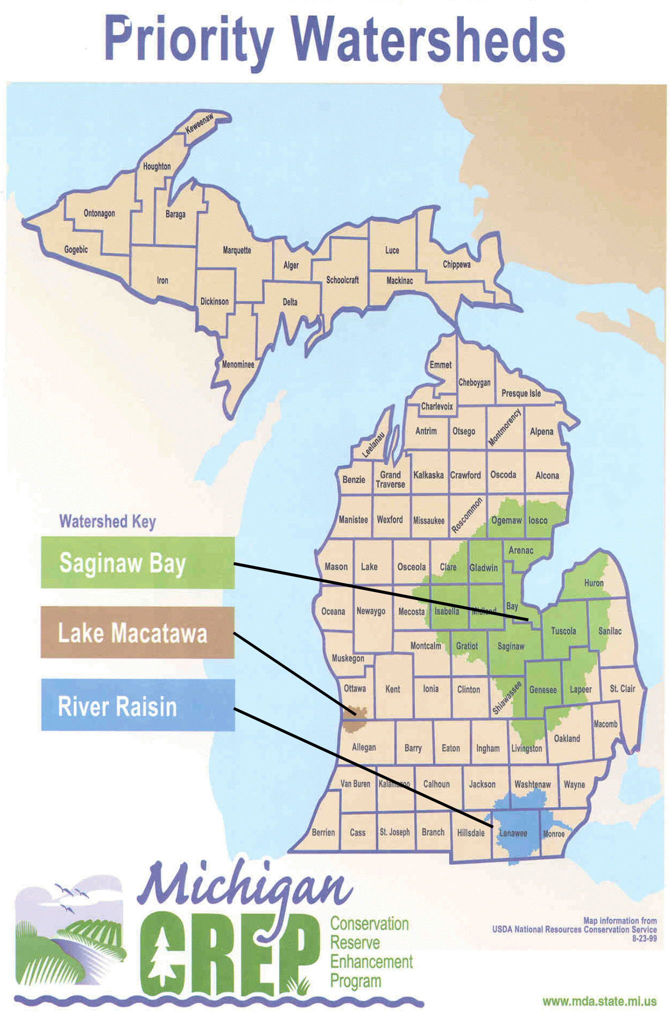
The Michigan Department of Agriculture (MDA) is the lead agency for the State and has partnered with the USDA and various other public and private conservation groups to develop a program to improve the water quality in three unique watersheds in Michigan. Pursuant to the agreement with the USDA, the Michigan CREP will involve, initially, a total of 80,000 acres of land in the Lake Macatawa, River Raisin, and Saginaw Bay watersheds. Michigan's CREP will be tailored to address the local needs of each watershed in terms of non-point source pollution, ground and surface water issues, soil erosion, and wildlife habitat issues. Figure 1 displays the priority watersheds in Michigan to be covered by CREP.

The Michigan CREP is designed to meet specific, measurable environmental goals through the use of eight select conservation practices. These conservation practices attempt to mitigate the adverse impacts of production agriculture on water quality and wildlife in the three watersheds. Only eligible land within the project area that is not currently under an existing CRP contract may be enrolled in CREP. Landowners will be enrolled in the program on an continuous basis until the authorized 80,000 acres are under contract or December 31, 2002, whichever is sooner. As of August 30, 2001, 27,000 acres were enrolled in CREP. Of this total, 10,000 acres have approved conservation practice plans and are under signed contracts with the USDA.

Under Michigan's program, CREP participants are eligible for various payments from the USDA and the State. The USDA is responsible for 50% of the conservation practice installation costs. In addition to the one-time cost-share payment, the USDA will provide a one-time incentive payment of $140 to $150 per acre and/or 40% of the total practice installation costs, depending on the conservation practice. Once the practice is in place, the USDA will provide landowners with annual payments, including a base rental payment representing the soil rental rate[1] (SRR) of the land, an incentive payment equal to 40% of the SRR, and a maintenance payment of $5 to $10 per acre. The USDA will make these payments directly to landowners under a consolidated annual CRP payment.

Michigan also will provide annual and lump sum payments. Michigan will cover the other 50% of the practice installation costs, thereby eliminating

Figure 1



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[1] Soil rental rate is determined by the USDA and can vary by county and sometimes within counties.

any monetary costs to the producer of implementing eligible conservation practices. Once the conservation practice is established, Michigan also will provide an annual incentive payment equal to 10% of the SRR. Pursuant to the CREP agreement, the State of Michigan also is responsible for a voluntary easement program whereby the State will purchase development rights.

State funding to encourage conservation practices will come from a combination of State resources, including restricted and General Fund/General Purpose revenue. Table 1 lists the funding identified for Michigan's CREP over the next 15 years. State restricted resources will support those conservation practices related to the intended purpose of the restricted funding source to ensure the appropriate and consistent use of such funds. State funding for CREP has been included in a number of appropriation acts dating back to fiscal year (FY) 1997-98, with the balances of the appropriations carried forward each year as work projects. Federal funding will not be appropriated through the State budget as the Federal portion of the CREP payments will be made directly by the USDA through the CRP agreements with landowners.

Table 1: Funding for Michigan's CREP

State Sources - Various	
Clean Michigan Initiative-Clean Water	$5,000,000
Clean Michigan Initiative-Non Point Source Pollution Control	4,000,000
Department of Natural Resources-GF/GP [1]	10,000,000
Department of Natural Resources-Game and Fish	6,000,000
Private Funding-Ducks Unlimited	$500,000
Federal Funding - USDA	$145,500,000
TOTAL	$171,000,000

[1] As part of the agreement to balance the FY 2000-01 budget, the State Budget Office reduced the work project balance of this appropriation by $4,125,000.

In addition to its financial commitments for the selected conservation practices, the State of Michigan will be responsible for an annual monitoring program, technical assistance, and a public information/education program. These activities will be supported by the efforts of the Michigan Departments of Agriculture, Environmental Quality, and Natural Resources, as well as Ducks Unlimited.

Michigan's CREP agreement with the USDA requires the State to develop a voluntary easement program. The State is solely responsible for all costs associated with this program, including securing easements, monitoring, and enforcement.

Public Act 176 of 2001

Public Act (P.A.) 176 of 2001 (Enrolled House Bill 5013) amended Part 82 of the Natural Resources and Environmental Protection Act to allow the Michigan Department of Agriculture to develop conservation programs designed to encourage conservation practices in the State. This legislation provides the requisite statutory authority for the MDA to implement some of the State's commitments under the CREP agreement. Specifically, P.A. 176 authorizes the Department, in implementing the conservation programs, to:

- Enter into contracts with one or more people for the implementation of conservation practices on their land.
- Enter into contracts or other agreements with one or more persons to administer or promote conservation programs or to implement conservation practices.
- Provide payments, financial incentives, or, upon verification, reimbursement for rental payments, or for costs of conservation practice implementation.
- Promote the use of conservation practices.
- Recognize and provide awards for people who have implemented conservation practices.
- Monitor and verify compliance with conservation plans.
- Enforce contracts or other agreements.

The Act also authorizes the MDA to provide for conservation practice plan verification, including on-site inspections of conservation practices. Based on a determination made by the

Department, it may revoke a person's conservation practice verification. A revocation may subject a person to penalties and repayment of all or a portion of the payments, financial incentives, rental payments, and conservation practice implementation cost-share payments.

In addition, P.A. 176 creates the Agriculture Pollution Prevention Fund in the State Treasury to receive money or other assets from any source. Current State appropriations for CREP are redirected to the Agriculture Pollution Prevention Fund to consolidate the dedicated funding within the MDA. The State Treasurer will direct the investment of the Fund and credit any interest and earnings to it. Money in the Fund is subject to appropriation and dedicated for conservation-related programs. In addition, up to 20% of the annual appropriations from the Fund may be used for the administrative costs of the Department related to implementing the conservation programs.

THE STATE CAMPAIGN FUND
by Jessica Runnels, Fiscal Analyst

Most taxpayers recognize the line on the Michigan income tax form asking if they would like $3 of their taxes to benefit the State Campaign Fund. What is the State Campaign Fund, what does it do, and why is this question on the tax form?

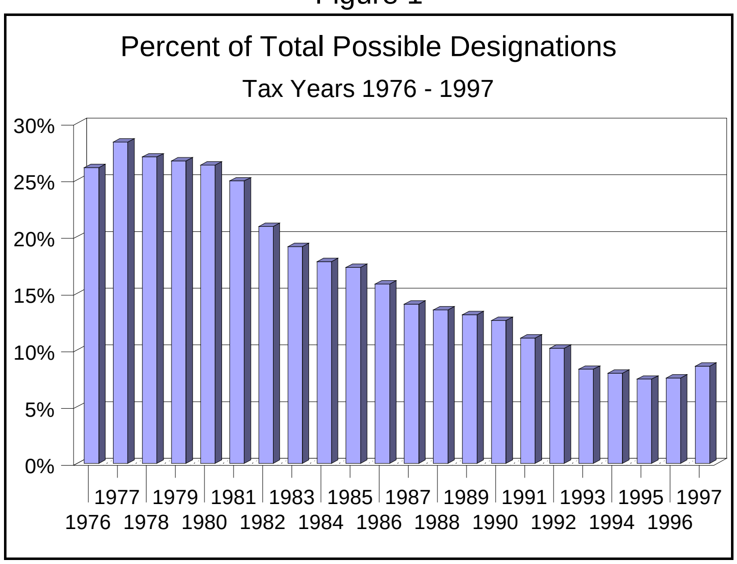
Introduction

The State Campaign Fund was created by Public Act 388 of 1976 in the Michigan Campaign Finance Act (MCL 169.201-169.282). This Act was modeled after the Federal Election Campaign Act of 1971 and incorporated the *Buckley* v *Valeo*, 424 U.S. 1 (1976), ruling by the U.S. Supreme Court that campaign spending limits cannot be enforced unless candidates are using public funds. Distributions from the State Campaign Fund are available to qualifying candidates during the primary and general elections for the Office of Governor. By making public funds available and creating incentives for candidates to use them, the State of Michigan can enforce limitations on expenditures by gubernatorial candidates. Designations from Michigan income tax filings provide the sole source of support for the State Campaign Fund.

Administration of the State Campaign Fund

When a taxpayer checks that box on the income tax form, $3 of his or her taxes paid will be deposited into the State Campaign Fund. Checking this box does not increase a taxpayer's payment, but designates $3 from the taxes paid for this specific purpose. Deposits are made once a year, on the January 1 following the income tax filing deadline for a tax year. At that time, the total amount of the designations made from the previous tax year is transferred from the State General Fund to the State Campaign Fund. The next deposit will be on January 1, 2002, for the 2000 tax year. The original designation was $2. Public Act 262 of 1993 increased the designation to $3. Table 1 presents data on the number of taxpayers designating a contribution to the State Campaign Fund and the revenue received for each tax year since the Fund was created. Totals are given by election cycle. The number of taxpayers choosing to contribute to the Fund has declined steadily over the past 24 years, as Figure 1

Figure 1



demonstrates. This figure shows actual designations as a percentage of the total taxpayers eligible to contribute to the Fund.

Table 1: State Campaign Fund Designations

Year	Number of Designations	Dollar Amount Collected
1976	1,303,780	$2,607,560
1977	1,460,000	2,920,000
Total	2,763,780	$5,527,560
1978	1,427,200	2,854,400
1979	1,422,100	2,844,200
1980	1,357,600	2,715,200
1981	1,273,300	2,546,600
Total	5,480,200	$10,960,400
1982	1,042,300	2,084,600
1983	952,400	1,904,800
1984	899,000	1,798,000
1985	918,500	1,837,000
Total	3,812,200	$7,624,400
1986	887,800	1,775,600
1987	787,600	1,575,200
1988	779,000	1,558,000
1989	767,300	1,534,600
Total	3,221,700	$6,443,400
1990	741,900	1,483,800
1991	653,000	1,306,000
1992	593,000	1,186,000
1993[a)]	491,300	1,473,900
Total	2,479,200	$5,449,700
1994	473,600	1,420,800
1995	437,200	1,311,600
1996	459,400	1,378,200
1997	469,054	1,407,162
Total	1,839,254	$5,517,761
1998	429,632	1,288,896
1999	393,111	1,179,333
2000[b)]	494,207	1,482,621
2001[b)]	466,667	1,400,000
Total	1,783,617	$5,350,850

[a)] Amount for designation changed from $2 to $3 in 1993. [b)] Estimate.

Source: Department of State and Department of Treasury

The balance in the State Campaign Fund does not lapse to the General Fund at the close of each fiscal year, but remains in the Campaign Fund until after the next gubernatorial general election. The money in the Fund is invested as common cash funds and any interest earned is credited to the General Fund, not the State Campaign Fund. Public Act 262 of 1993 added the provision that only the balance in excess of $10,000,000 will lapse to the General Fund following a gubernatorial election year. Until that amendment was adopted, the entire balance of the Fund lapsed to the General Fund following the election. The gubernatorial election of 1994 was the first year the Campaign Fund balance was carried forward to the next election. As Table 2 shows, the statutory cap of $10,000,000 on the carryforward balance is millions of dollars greater than any potential carryforward before this provision was enacted.

Table 2: State Campaign Fund Collections & Expenditures

1976	
Collections	$5,527,560.00
Expenditures	2,940,801.74
Balance	2,586,758.26
1982	
Collections	10,960,400.00
Expenditures	5,760,443.30
Balance	5,199,956.70
1986	
Collections	7,624,400.00
Expenditures	2,965,846.60
Balance	4,658,553.40
1990	
Collections	6,443,400.00
Expenditures	4,229,054.44
Balance	2,214,345.56
1994	
Collections	5,449,700.00
Expenditures	5,368,252.71
Balance	81,447.29
1998	
Carryforward	81,447.29
Collections	5,517,762.00
Total	5,599,209.29
Expenditures	3,415,694.29
Balance	2,183,515.00
2002	
Carryforward	2,183,515.00
Collections	5,350,850.00
Total	7,534,365.00

Source: Department of State

Disbursements from the Fund are coordinated between the Department of State and the Department of Treasury. The Department of State certifies a candidate committee's request for public funds and Department of Treasury actually releases the funds to the committee following certification. Before any funds are disbursed, representatives from the two departments estimate the public fund requests for the general election. This amount is set aside and the remainder may be distributed to primary candidates. The amount set aside for the general election is twice the maximum available to each major party candidate and an additional amount for minor party candidates. Minor party candidates are entitled to a distribution if their party received at least 5% of the votes cast in the last election for the same office; otherwise, minor party candidates who receive at least 5% of the votes cast in a general election for governor are eligible for reimbursement. The amount received by a minor party candidate is a function of the number of votes received by all the candidates and the amount of public funds distributed to the major party candidates. No disbursement has ever been made to a minor party candidate. The amount set aside for the 2002 general election is $2,450,000, leaving $5,084,365 for the primary election. After the general election set aside, if insufficient funding exists to fully match primary candidates' requests, then the funds are distributed on a pro rata basis.

Candidate Responsibilities

Public funds are available to both primary and general election gubernatorial candidates. Candidates who receive public funds must adhere to the election expenditure limits. There is one exception: If a candidate exceeds the personal or family contribution limit of $340,000 per election cycle, then all of that candidate's opponents may exceed the expenditure limit. This has occurred once in the history of the State Campaign Fund. The Democratic candidate in the 1998 gubernatorial election contributed more than the personal contribution limit during both the primary and general elections and did not receive any public funds. As a result, the Democratic primary candidates and the Republican candidate in the general election were permitted by statute both to receive public funds and to exceed the expenditure limit. In addition, more than $2.3 million of unused public funding was carried forward for use in the 2002 election. Table 3 details the expenditures during the primary and general elections by political party since the inception of the State Campaign Fund.

Public funds must be maintained in a bank account separate from private contributions and may be spent only on approved expenses. "Qualified campaign expenditure" means "an expenditure for services, materials, facilities, or other things of value by the candidate committee to further the candidate's nomination or election to office during the year in which the primary or general election in which the candidate seeks nomination or election is held" (MCL 169.266). Certain expenses are not qualified; these include payments to a business the candidate or a relative is associated with, any portion of the salary of an employee earning more than $5,000 per month, payments from petty cash, gifts, and incidental expenses for the elected office once the candidate is elected. Private funds may be used for unqualified expenses. Some expenses,

Table 3: Public Funds Spent

	Primary Election			General Election			
Year	**Democrat**	**Republican**	**Total**	**Democrat**	**Republican**	**Total**	**Grand Total**
1978	$1,280,156.16	$161,389.82	$ 1,441,545.98	$749,481.66	$749,774.10	$ 1,499,255.76	$ 2,940,801.74
1982	2,217,279.93	2,044,250.24	4,261,530.17	748,913.13	750,000.00	1,498,913.13	5,760,443.30
1986	660,000.00	805,846.60	1,465,846.60	750,000.00	750,000.00	1,500,000.00	2,965,846.60
1990	989,054.44	990,000.00	1,979,054.44	1,125,000.00	1,125,000.00	2,250,000.00	4,229,054.44
1994	2,229,135.51	889,117.20	3,118,252.71	1,125,000.00	1,125,000.00	2,250,000.00	5,368,252.71
1998	1,300,694.29	990,000.00	2,297,200.30	0.00	1,125,000.00	1,125,000.00	3,415,694.29

Source: Department of State

such as those incurred for compliance with campaign finance regulations, are exempt from the spending cap. Any public funds remaining after 60 days following the election for which they were received must be refunded and credited to the State Campaign Fund. Any interest earned on public funds while in the bank account of a candidate committee must be credited to the State Campaign Fund and may not be used by the committee for campaign purposes.

Primary Election. During the primary, public funds are available for a two-to-one match, meaning that every $1 of individual contributions is eligible for a $2 public funds match, for a total of $3. Candidates must demonstrate $75,000 in qualified contributions to receive the first matching public funds during the primary election. Qualified contributions must be made by written instruments by an individual Michigan resident in an amount of $100 or less in the calendar year of the gubernatorial election or after April 1 of the year immediately preceding it. Subsequent requests for funds may be in smaller amounts. Primary candidates may receive up to $990,000 in public funds, which would require a candidate to demonstrate at least $495,000 in qualified contributions. The total expenditure cap for the primary election is $2,000,000 per candidate.

Candidates are eligible to receive public funds if they have filed a statement of organization in accordance with the Michigan Campaign Finance Act (MCL 169.224). Disbursements are made to the committee when a listing of qualified contributions is certified by the Department of State Bureau of Elections. A candidate committee submits the contribution list to the Bureau, which reviews the name, address, signature, and other information for individual contributions. This process may take a few days if the contributor list is long or incorrect. Once approved, the funds are released by the Department of Treasury to the candidate's committee. For initial disbursements, the public funds may be allotted on a pro rata basis. Future disbursements may compensate for the unmatched qualified contributions depending on the actual funds available closer to the primary election.

General Election. Each of the major party candidates chosen at the primary election receives $1,125,000 from the State Campaign Fund. The candidates are not required to submit matching contributions to receive this money and private funds remaining from the primary election may be carried over for expenditure in the general election for eligible candidates. Unused public funds received for use in the primary election must be returned to the State Campaign Fund, even by the winner of the primary election.

Candidates receive funds from the State Campaign Fund for use in the general election after the results of the August primary are certified. If unofficial results demonstrate a clear winner in the primary by at least 2% of the votes cast for the top two candidates, the winner may receive $56,250 of the public funding for the general election within 10 days of the primary election. The balance must be transmitted to the candidate's committee within three days of the official certification of the primary election results.

There is an expenditure cap of $2,000,000 for the general election. A candidate accepting public funds may spend a total of $4,000,000 during the primary and general elections. If a candidate exceeds the expenditure cap for the primary election, the candidate still may receive public funds in the general election if he or she agrees not to exceed the cap for the general election.